



**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and Required Supplementary Information

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis – Required Supplementary Information	3 - 8
Statements of Net Assets	9
Statements of Revenues, Expenses, and Changes in Net Assets	10
Statements of Cash Flows	11
Notes to Financial Statements	12 - 27



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Independent Auditors' Report

The Board of Trustees
Massachusetts Water Pollution Abatement Trust:

We have audited the accompanying financial statements of the Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts, as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



In accordance with *Government Auditing Standards*, we have also issued our report, dated October 17, 2006, on our consideration of the Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

October 17, 2006

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information
Management's Discussion and Analysis
June 30, 2006 and 2005

Management's Discussion and Analysis

The following is management's discussion and analysis of the financial position and activities of the Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts, for the fiscal years ended June 30, 2006 and 2005. This discussion is a narrative overview and analysis of our financial activities and should be read in conjunction with the accompanying financial statements.

Financial Highlights – Fiscal 2006

- Assets exceed liabilities by \$1.5 billion, a 6.8% increase over FY05 at the close of the fiscal year. Included in this number is loans receivable, which increased from \$2.5 billion in FY05 to \$2.7 billion in FY06 and debt, which increased from \$2.6 billion in FY05 to \$2.8 billion in FY06.
- Net assets increased by \$97.5 million from last year, an increase of 6.8%.
- Operating income increased by \$16.4 million from FY05, resulting in operating income of \$15.5 million in FY06.
- The statement of cash flows indicates an increase in cash for the year of \$13.0 million.
- In FY06, the Trust continued to receive Capitalization Grants from the Environmental Protection Agency for both the Clean Water and Safe Drinking Water programs. The Trust received \$36.6 million from the Clean Water Program and received \$29.6 million in the State Drinking Water Program. The Commonwealth provided a match of \$30.2 million for these federally funded programs. The continued capitalization of the Trust, combined with the Trust's access to the bond market, has allowed the Trust to provide funding to all qualified borrowers.
- The Trust continues to maintain its ratings from all three major rating agencies on our bonds, allowing the Trust to continue to provide funds to communities at the lowest cost possible. The Trust's current ratings are:

<u>Ratings on Trust debt</u>	<u>Fitch IBCA</u>	<u>Moody's Investor's Service, Inc.</u>	<u>Standard & Poor's</u>
Pooled Loan Program	AAA	Aaa	AAA
MWRA Loan Program	AA+ – AAA	Aaa	
New Bedford Loan Program	AA – AAA	Aaa (insured) Aa3 (underlying)	
South Essex Sewerage District Loan Program	AA	Aaa	

Financial Highlights – Fiscal 2005

- Assets exceed liabilities by \$1.4 billion, a 7% increase over FY04, at the close of the fiscal year. Included in this number is loans receivable, which increased from \$2.3 billion in FY04 to \$2.5 billion in FY05.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information
Management's Discussion and Analysis
June 30, 2006 and 2005

- Net assets increased by \$96.1 million from last year, an increase of 7%.
- The operating loss of \$11.2 million from FY04 compares with operating income of \$853 thousand in FY05.
- The statement of cash flows indicates an increase in cash for the year of \$16.2 million.
- In FY05, the Trust continued to receive its Capitalization Grants from the Environmental Protection Agency in both the Clean Water and Safe Drinking Water programs. The Trust received \$45.4 million from the Clean Water Program and received \$29.7 million in the State Drinking Water Program. The Commonwealth provided a match of \$30.2 million for these federally funded programs. This has allowed the Trust to continue to expand the base of capital in the Revolving Fund and support the administrative costs without having to heavily rely on the Commonwealth of Massachusetts to keep the program viable.
- The Trust issued a new series of bonds in August 2004, the 2004A Refunding Bonds – that advance refunded several previously issued bonds. This new issue will ultimately reduce the cost of the Trust's debt service by \$42.9 million over the next 25 years.
- The Trust continues to maintain its ratings from all three major rating agencies on our bonds, thus allowing the Trust to continue to provide funds to communities at the lowest cost possible. The Trust's ratings in FY05 were:

<u>Ratings on trust debt</u>	<u>Fitch IBCA</u>	<u>Moody's Investor's Service, Inc.</u>	<u>Standard & Poor's</u>
Pooled Loan Program	AAA	Aaa	AAA
MWRA Loan Program	AAA	Aaa	AAA
New Bedford Loan Program	AAA	Aaa (insured) Aa3 (underlying)	AAA
South Essex Sewerage District Loan Program	AAA	Aaa	AAA

Overview of Financial Statements

The financial section of this report consists of the following parts: management's discussion and analysis (this section), the basic financial statements and the notes to the financial statements.

The Trust's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government enterprise funds. Under this method of accounting, an economic resources measurement focus and an accrual basis of accounting is used. Revenue is recorded when earned, and expenses are recorded when incurred. The basic financial statements include statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows. This report also includes footnotes accompanying the statements to fully explain the activities reported in them.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)
Required Supplementary Information
Management's Discussion and Analysis
June 30, 2006 and 2005

The statements of net assets present information on the assets and liabilities of the Trust. The difference between the two is net assets. Over time, increases and decreases in net assets may be an indicator of the strength or deterioration of the financial health of the Trust.

The statements of revenues, expenses, and changes in net assets report the operating revenues and expenses and the nonoperating revenues and expenses of the Trust for the fiscal year. The difference – increase or decrease in net assets – then determines the net change in assets for the fiscal year. This change in net assets added to last year's net assets will reconcile to the total net assets for this fiscal year.

The statements of cash flows report activity of cash and cash equivalents during the fiscal year resulting from operating activities, capital and related financing activities, noncapital financing activities, and investing activities. The net result of these activities is reconciled to the cash and cash equivalent balances reported at the end of the fiscal year. This statement is prepared using the direct method of presentation which allows the reader to easily discern the amount of cash received from grantors, borrowers and financial institutions and how much cash was disbursed to borrowers, suppliers and bondholders.

Financial Analysis of the Trust

Net Assets

The Trust's net assets at June 30, 2006 were approximately \$1.5 billion, a 6.8% increase over the prior year (see Table A-1). Total assets increased 6.2% to \$4.5 billion, and total liabilities increased 5.9% to \$3.0 billion.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information
Management's Discussion and Analysis
June 30, 2006 and 2005

The Trust's net assets at June 30, 2005 were approximately \$1.4 billion, a 7.2% increase over the prior year (see Table A-1). Total assets increased 10.6% to \$4.3 billion, and total liabilities increased 12.3% to \$2.8 billion.

Table A-1
Massachusetts Water Pollution Abatement Trust's Net Assets

(In thousands)

	2006	2005	2004	Percentage change	
				2006-2005	2005-2004
Current assets	\$ 590,011	605,488	548,343	(3)%	10%
Loans receivable, long term	2,567,513	2,388,370	2,181,641	8	9
Other	1,358,131	1,259,311	1,117,289	8	13
Total assets	\$ 4,515,655	4,253,169	3,847,273	6	11
Current liabilities	\$ 206,975	196,426	172,987	5	14
Long-term debt	2,682,113	2,502,266	2,210,839	7	13
Other	93,664	119,105	124,180	(21)	(4)
Total liabilities	2,982,752	2,817,797	2,508,006	6	12
Net assets:					
Restricted	1,390,493	1,322,417	1,212,805	5	9
Unrestricted	142,410	112,955	126,462	26	(11)
Total net assets	\$ 1,532,903	1,435,372	1,339,267	7%	7%

Operating revenues decreased by 4% from 2005 to 2006 as a result of a 4% decrease in interest income. This decrease in interest income is a result of lower market rates charged by the Trust on its loan portfolio. Nonoperating revenues decreased 14% from 2005 to 2006 as a result of a reduced federal appropriation for capitalization grants in 2006 and a \$2.5 million decrease in additional contract assistance from the Commonwealth.

Long-Term Debt

The Trust incurs debt in order to fund communities' construction projects under the Clean Water and Drinking Water programs. This debt is offset by the loans receivable carried on the Trust's Statements of Net Assets and the debt service requirements of this debt are secured by loan repayments by the borrowers, investment earnings on a debt service reserve fund established for each bond issuance, and Commonwealth "contract assistance" subsidies.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information
Management's Discussion and Analysis
June 30, 2006 and 2005

In FY06, the Trust's debt position increased by \$190 million to \$2.8 billion. This increase is the net change in debt due to the issuance of the Pooled Loan Program, Series 11 issue of \$293.7 million and the retirement of \$111.6 million of outstanding principal through regular payments to bondholders. In FY05, The Trust also issued \$645.6 million in additional bonds to advance refund \$592 million of previously issued debt to take advantage of the current low interest rate environment. This refunding will net the Trust \$42.9 million (\$26.7 million net present value) in total annual savings over the next 25 years.

Table A-2
Changes in the Massachusetts Water Pollution Abatement Trust's Net Assets
(In thousands)

	<u>2006</u>	<u>June 30, 2005</u>	<u>2004</u>	<u>Percentage change 2006-2005</u>	<u>2005-2004</u>
Operating revenues:					
Interest income	\$ 163,391	170,646	135,715	(4)%	26%
Other	3,674	3,603	2,040	2	77
Total operating revenues	<u>167,065</u>	<u>174,249</u>	<u>137,755</u>	<u>(4)</u>	<u>26</u>
Operating expenses:					
Interest expense	134,079	136,457	114,676	(2)	19
Grant disbursements	—	20,836	15,422	(100)	35
Program support	15,306	13,215	15,394	16	(14)
Other	2,180	2,888	3,466	(25)	(17)
Total operating expenses	<u>151,565</u>	<u>173,396</u>	<u>148,958</u>	<u>(13)</u>	<u>16</u>
Operating income (loss)	<u>15,500</u>	<u>853</u>	<u>(11,203)</u>	<u>1,717</u>	<u>(108)</u>
Nonoperating revenues:					
Operating grants	8,507	10,983	7,853	(23)	40
Capitalization grants	73,524	84,269	37,815	(13)	123
Total nonoperating income	<u>82,031</u>	<u>95,252</u>	<u>45,668</u>	<u>(14)</u>	<u>109</u>
Change in net assets	97,531	96,105	34,465	1	179
Total net assets, beginning of year	<u>1,435,372</u>	<u>1,339,267</u>	<u>1,304,802</u>	<u>7</u>	<u>3</u>
Total net assets, end of year	<u>\$ 1,532,903</u>	<u>1,435,372</u>	<u>1,339,267</u>	<u>7%</u>	<u>7%</u>

The 4% decrease in operating revenues from 2005 to 2006 is due primarily to a 4% decrease in interest income. Nonoperating revenues decreased by 14% due to reductions in Federal EPA Capitalization Grants and State Contract Assistance.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Required Supplementary Information
Management's Discussion and Analysis

June 30, 2006 and 2005

Operating expenses decreased by 13% due to the decreases in grant disbursements and program support. Grant disbursements were reduced from \$20.8 million in FY05 to \$0 in FY06 as a result of a policy change which is described in footnote 10. Prior to FY06, bond premiums realized by the Trust were passed through to borrowers as grant disbursements. Beginning with the Pool Program, Series 11 bonds issued in November 2005, the Trust includes proceeds from bond premiums in the par amount of loans provided to its borrowers, eliminating the grant treatment of such amounts.

Loans Receivable

Subsidized financing has been an important incentive for many communities to undertake water and sewer infrastructure improvement projects. Since the enactment of Chapter 95 of the Acts of 1995, the Trust has been the Commonwealth's primary program to finance such improvements.

The Trust provides funding to communities through low-interest loan programs. The rate for Trust loans is set by statute at 2%, although projects approved prior to 2002 may qualify for a lower rate. The Trust's loan programs are very attractive to borrowers, and the Trust's loan portfolio continues to grow. Loan receivables increased from \$2.6 billion to \$2.8 billion, an increase of 8.2%, in FY06.

Future Economic Factors

In August 2002, the Commonwealth enacted Chapter 236 of the Acts of 2002. Sections 4 and 5 of the Act provide for \$46.5 million in matching capitalization funds for the Federal Clean Water programs for the fiscal years of 2003 to 2007. For the Federal Drinking Water Program, the Trust maintains a balance from a prior appropriation which we estimate will be exhausted in late FY06. The Trust has submitted a request to the Legislature for an additional appropriation of \$13.2 million which would allow the Trust to continue to receive Federal Drinking Water grants through FY08. The Trust expects the Legislature to act on this request during the 2007 legislative session.

Requests for Information

This financial report is intended to provide an overview of the financial picture of the Massachusetts Water Pollution Abatement Trust for those with an interest in the agency. Any further questions regarding any of the information contained within this report may be directed to the Executive Director or the Controller at One Ashburton Place, 12th Floor, Boston, MA 02108.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Net Assets

June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Assets:		
Current assets:		
Cash and cash equivalents (note 3)	\$ 281,797	268,801
Short-term investments (note 3)	25,937	85,581
Grants receivable:		
U.S. Environmental Protection Agency	15,931	14,418
Commonwealth of Massachusetts	10,060	13,150
Loans receivable, current (note 5)	171,382	141,954
Accrued interest receivable	84,904	81,584
Total current assets	<u>590,011</u>	<u>605,488</u>
Noncurrent assets:		
Project fund investments (note 3)	91,672	117,418
Loans receivable, long-term (note 5)	2,567,513	2,388,370
Long-term investments (note 3)	1,259,633	1,134,813
Other assets	6,826	7,080
Total noncurrent assets	<u>3,925,644</u>	<u>3,647,681</u>
Total assets	<u>4,515,655</u>	<u>4,253,169</u>
Liabilities:		
Current liabilities:		
Accrued expenses	—	13
Accrued interest payable	58,993	54,842
Current portion:		
Loan commitments and project funds payable	25,937	29,916
Long-term debt (note 6)	122,045	111,655
Total current liabilities	<u>206,975</u>	<u>196,426</u>
Noncurrent liabilities:		
Loan commitments and project funds payable	91,672	117,418
Accrued interest on capital appreciation bonds	1,992	1,687
Long-term debt, net (note 6)	2,682,113	2,502,266
Total noncurrent liabilities	<u>2,775,777</u>	<u>2,621,371</u>
Total liabilities	<u>2,982,752</u>	<u>2,817,797</u>
Net assets:		
Restricted (note 7)	1,386,709	1,319,287
Restricted – contract assistance (note 7)	3,784	3,130
Unrestricted (note 7)	142,410	112,955
Commitments and contingencies (note 8)		
Total net assets	<u>\$ 1,532,903</u>	<u>1,435,372</u>

See accompanying notes to financial statements.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Loan servicing fees	\$ 3,646	3,407
Loan origination fees	28	196
Interest income	163,391	170,646
Total operating revenues	<u>167,065</u>	<u>174,249</u>
Operating expenses:		
Commonwealth of Massachusetts:		
Department of Environmental Protection – programmatic support costs	15,306	13,215
General and administrative	1,145	1,362
Arbitrage rebate payments	1,035	1,526
Grant disbursements (note 6)	—	20,836
Interest expense	134,079	136,457
Total operating expenses	<u>151,565</u>	<u>173,396</u>
Operating income	<u>15,500</u>	<u>853</u>
Nonoperating revenue:		
Operating assistance:		
Commonwealth of Massachusetts	7,853	7,853
Contract assistance:		
Commonwealth of Massachusetts (note 7)	654	3,130
Capitalization grant revenue:		
U.S. Environmental Protection Agency capitalization grants	66,207	75,069
Commonwealth of Massachusetts matching grants	7,317	9,200
Total nonoperating revenue	<u>82,031</u>	<u>95,252</u>
Increase in net assets	97,531	96,105
Beginning of year net assets	<u>1,435,372</u>	<u>1,339,267</u>
End of year net assets	<u>\$ 1,532,903</u>	<u>1,435,372</u>

See accompanying notes to financial statements.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Statements of Cash Flows

Years ended June 30, 2006 and 2005

(In thousands)

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Other cash received from borrowers	\$ 3,675	3,609
Grants disbursed to recipients	—	(20,836)
Cash paid to suppliers	(17,246)	(19,090)
Net cash used for operating activities	(13,571)	(36,317)
Cash flows from capital and related financing activities:		
Proceeds from USEPA capitalization grants	64,694	75,894
Proceeds from Commonwealth matching capitalization grants	10,407	11,700
Net cash provided by capital and related financing activities	75,101	87,594
Cash flows from noncapital financing activities:		
Bonds proceeds	304,069	405,027
Repayment of bonds	(111,655)	(99,260)
Interest paid	(127,699)	(128,172)
Contract assistance	654	3,130
Operating assistance from Commonwealth of Massachusetts	7,853	7,853
Other	320	—
Net cash provided by noncapital financing activities	73,542	188,578
Cash flows from investing activities:		
Loans disbursed to recipients	(380,250)	(348,678)
Cash received from borrowers	141,954	128,222
Purchases of investments	(303,884)	(469,486)
Proceeds from maturities of investments	264,454	320,450
Interest received	155,650	145,823
Net cash used for noncapital financing activities	(122,076)	(223,669)
Net increase in cash and cash equivalents	12,996	16,186
Cash and cash equivalents, beginning of year	268,801	252,615
Cash and cash equivalents, end of year	\$ 281,797	268,801
Reconciliation of operating income to net cash used for operating activities:		
Operating income	\$ 15,500	853
Adjustments to reconcile operating income to net cash used for operating activities:		
Reclassification of:		
Interest income	(163,391)	(170,646)
Interest expense	134,079	136,457
Changes in operating assets and liabilities:		
Loan servicing fees receivable	—	6
Other assets and liabilities, net	254	(2,628)
Accrued expenses	(13)	(359)
Net cash used for operating activities	\$ (13,571)	(36,317)

Noncash activity:

During 2005, the Trust issued \$645.6 million of bonds to advance refund \$592.9 million of outstanding bonds through an “in-substance” defeasance transaction.

See accompanying notes to financial statements.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

(1) Organization

The Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts (the Commonwealth), was created by Chapter 275 of the Acts of 1989 of the Commonwealth (the Act) to implement the State Revolving Fund (the SRF) Program for the Commonwealth, contemplated by Title VI of the Federal Clean Water Act (the CWA). The Trust is governed by a board of trustees consisting of the State Treasurer, the Secretary of the Executive Office for Administration and Finance, and the Commissioner of the Department of Environmental Protection (the DEP).

The financial and management activities of the Trust are administered by employees of the State Treasurer's office. The project oversight and direction is provided by the DEP. Certain financial oversight is provided by the Executive Office for Administration and Finance. The Trust commenced operations in June 1990. The long-term goals of the Trust include creating and implementing an SRF program that provides a source of financing for water pollution abatement projects (the projects). Construction of projects on the National Municipal Policy List, the cleanup of Boston Harbor, and the correction of combined sewer overflows (CSO) are prime focuses for the federal SRF Program.

The Trust is authorized by the Act to borrow money through the issuance of revenue bonds and to apply the proceeds thereon, together with federal and state capitalization grants and other funds made available to the Trust, to make loans to local governmental units to finance the costs of eligible water pollution abatement projects (the Leveraged Loan Program).

During fiscal 1993, the legislature enacted an amendment to the Act. This law, Chapter 203 of the Acts of 1992 (Chapter 203), states that all eligible loans made by the Trust can have subsidies that accomplish a grant equivalency of 25%. This amendment further directs that certain projects on the DEP's Intended Use Plan prior to 1992 should receive higher subsidy levels.

Chapter 203 also reduces the total authorization for Commonwealth general obligation bonds for the Trust from \$1.3 billion to \$122 million. State matching funds for the federal SRF and reserve funds for the Commonwealth SRF continue to be funded through a general obligation bond source. However, all subsidy contributions now come from a Commonwealth Contract Assistance Agreement that is provided through the Commonwealth's annual operating budget and cannot exceed \$26 million in any one fiscal year. This has the net effect of reducing authorized Commonwealth debt while still ensuring funding for a perpetual state revolving fund.

During fiscal 1994, the Trust established an Interim Loan Program and a Small Direct Loan Program for local government units' borrowing needs. The Interim Loan Program provides temporary short-term financing to local government units that are to be subsequently refinanced through permanent leveraged loans. The Small Direct Loan Program finances single small projects where leveraged loans would not be financially feasible for the local government units.

During fiscal 1996, the Commonwealth approved an amendment to Chapter 29C of the General Laws to provide a subsidy or other assistance equivalent to a grant of 50% of the eligible costs of the project

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

financed by the loan. The amendment is applicable for all loans issued after October 1, 1995. This amendment provides additional subsidy levels of up to \$8 million annually.

Amendments to the federal Safe Drinking Water Act adopted in 1996 provide for the establishment of additional state revolving fund programs to provide financial assistance to various community water systems (including for-profit companies) and not-for-profit noncommunity water systems for expenditures that will facilitate compliance with national drinking water regulations or otherwise advance the health protection objectives of the Safe Drinking Water Act. The Safe Drinking Water Act regulations and other guidance issued by the United States Environmental Protection Agency contemplate that state revolving fund programs established in accordance with the Safe Drinking Water Act will operate under terms and conditions substantially similar to programs developed under the federal Clean Water Act. In addition, the amendments to the Safe Drinking Water Act provide Authority for the consolidation of a Safe Drinking Water Act revolving fund with a Clean Water Act revolving fund for purposes of investment and the issuance of, and security for, bonds.

During fiscal 1998, the Trust created a new fund to account for the receipts and disbursements in conjunction with the Commonwealth's Title V regulations. The Community Septic Management Program Fund is the recipient of amounts bonded for in the Third Pooled Loan Program Financing on April 29, 1997 and the Fourth Pooled Loan Program Financing on December 9, 1998. It also is used for pass-through assistance payments from the Commonwealth to communities to fund administrative costs in setting up loan programs to homeowners at the community level.

The Enabling Act was amended by the Massachusetts legislature on April 2, 1998 to authorize the Trust to establish a revolving fund program under the Safe Drinking Water Act.

In fiscal year 2000, the State legislature changed the level of subsidies on Trust loans from the 50% grant equivalency level to a flat 2% interest rate to be charged on loans for new projects beginning with those appearing on the calendar year 2002 intended use plan,. This was in order to mitigate increases in contract assistance commitments by the Commonwealth, while the Trust could increase its leveraging ratio from 2:1 to 3:1, increasing funding capacity by 50%.

(2) Summary of Significant Accounting Policies

The accounting policies of the Trust conform to generally accepted accounting principles as applicable to government enterprises. The following is a summary of the Authority's significant accounting policies:

(a) Basis of Presentation

The Trust's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting as specified by the Governmental Accounting Standards Board's (GASB) requirements for an enterprise fund. Operating revenues and expenses are generated through the issuance of loans to local government units within the Commonwealth. All other revenues and expenses are reported as nonoperating revenues and expenses. During 2006, the Trust adopted GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*. The implementation of this statement had no impact on the accompanying financial statements.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

Under GASB Statement No. 20, *Accounting and Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Trust has elected to apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

(b) Cash and Cash Equivalents

The Trust's policy is to treat all highly liquid investments with original maturities of three months or less as cash and cash equivalents.

(c) Investments

Investments are carried at fair value. Where applicable, fair values are based upon quotations from national security exchanges.

Under the Massachusetts Water Pollution Abatement Trust Program Resolutions (the Resolutions), as amended and supplemented at various bond sale dates, the Trust must maintain certain investment funds in the Federal SRF Loan Program and Commonwealth SRF Loan Program with U.S. Bank and Wells Fargo Bank (the Trustees). The types of funds held by the Trustees are in the following accounts:

Equity Accounts – The Equity Fund consists of cash and cash equivalents which are currently held primarily at the Massachusetts Municipal Depository Trust (MMDT). The Equity Fund is comprised of both a federal program account and a Commonwealth program account and can be used for programmatic costs and operating expenses within the Federal SRF Loan Program or Commonwealth SRF Loan Program, as applicable. These funds are derived from: (1) funds drawn by the Trust from federal capitalization grants and Commonwealth matching funds; (2) other amounts paid to the Trust representing financial assistance provided pursuant to the Act for purposes of deposit in the Federal SRF Loan Program; (3) other amounts appropriated to the Trust by the Commonwealth for purposes of the Federal SRF Loan Program or Commonwealth SRF Loan Program; (4) direct loan repayment; (5) interest earnings on investment or deposits of amounts held in the Equity Fund; and (6) amounts transferred from the Debt Service Reserve Fund as a result of loan repayments in accordance with the provisions specified in the Resolutions.

Interim Loan Accounts – The Interim Loan Fund has been established to fund temporary loans in anticipation of permanent leveraged borrowings. The source of funds is the Equity Fund.

Project Accounts – The Project Funds disburse bond proceeds to borrowers as needed. These funds are restricted by the bond resolutions and are to be applied solely to the payment or refinancing of costs associated with the applicable project. When all costs have been paid, any amounts remaining unexpended in the Project Funds can be applied to the repayment of the applicable loan service to bondholders. The monies are derived from semiannual loan

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

repayments, which include payments from borrowers, interest earnings on the Debt Service Reserve Funds, and Commonwealth contract assistance payments.

Debt Service Reserve Accounts – Debt Service Reserve Funds consist of reserve requirements equal to 50% of the principal amount outstanding on Clean Water bonds and 40% on Drinking Water bonds. For bonds issued to finance loans authorized by the 2002 and subsequent “Intended Use Plans”, the debt service reserve fund requirement drops to 33.33% of the outstanding principal. In accordance with each bond resolution, amounts are transferred from the Equity Fund to the particular Debt Service Reserve Funds. Interest earnings on the Debt Service Reserve Funds are transferred to their corresponding Revenue Fund and used for debt service payments.

Debt Service Accounts – Debt Service Funds are used as a pass-through of principal and interest from the Revenue Funds to the bondholders. The Debt Service Funds are also used to hold accrued interest on the bonds to be applied to pay a portion of the interest due on the bonds.

(d) Capital Assets

The Trust’s capital asset capitalization policy conforms with the Commonwealth’s threshold of \$50,000. As of June 30, 2006 and 2005, the Trust did not have any capital assets.

(e) Bond-Related Costs, Premiums and Discounts, and Gains and Losses

Fees received and certain direct costs incurred, relating to the origination of loans, have been deferred and are included with loans receivable in the accompanying balance sheets. Loan origination fees and costs are amortized over the life of the loans to which the fees and costs relate using the straight-line method. Origination fees charged to leveraged borrowers are capped at the estimated costs of leveraged transactions as proposed in the Trust’s administrative budget and allocated to all borrowers, excluding the Title V program.

Bond premiums and discounts related to bonds issued, as well as deferred gains and losses on defeased bonds, are deferred and amortized over the lives of the bonds on the straight-line method.

(f) Risk Financing

The Trust is not insured for casualty, theft, tort claims, or other losses. No amounts have been accrued for such losses as they are not considered material. As discussed in note 1, all financial, management and project oversight activities are provided by employees of the State Treasurer’s Office, DEP, and the Executive Office for Administration and Finance. These employees are covered under the Commonwealth’s workers’ compensation and group insurance programs. The cost of these programs is allocated to the Trust, through the fringe benefit allocation. As described in note 4, the Trust is allowed to expend up to 4% of the federal capitalization grant on program administration costs; therefore, any costs in excess of this amount will be borne by the Commonwealth. As a result, no liability for workers’ compensation or group insurance has been recorded by the Trust.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

(g) Capitalization Grants

Funding from federal capitalization grants and state matching grants are recorded as nonoperating revenues.

(h) Other Assets

Other assets consist of the unamortized portion of bond issue costs, which are amortized using the straight-line method over the life of the bonds, and deferred charges, which are “unreclassified” state appropriations for matching funds that are allocated to administrative costs.

(i) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(3) Deposits and Investments

Effective July 1, 2004, the Trust implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. Cash, cash equivalents, and investments are separately held by several of the Trust’s funds.

(a) Cash and Cash Equivalents

The Trust’s cash and cash equivalents consists of bond proceeds received and not yet lent as well as project funds that have not yet been disbursed. All but a small portion of these amounts are held by trustees and disbursed in accordance with executed loan agreements. A small portion of the cash and cash equivalents are held to pay the administrative costs of the Trust.

Cash and cash equivalents are comprised of bank deposits as well as investments in the Massachusetts Municipal Depository Trust (MMDT), an external investment pool managed by the State Treasurer for cities, towns, and other state and local agencies. For purposes of risk categorization, MMDT shares are not categorized. The fair value of the Trust’s position in MMDT is the same as the value of MMDT shares.

Custodial Credit Risk – Deposits. Custodial credit risk for deposits is the risk that in the event of a bank failure, the Trust’s deposits may not be returned to it. The Trust does not have a deposit policy for custodial credit risk.

At the end of the year, carrying amounts of the Trust’s deposits were \$0 and \$1,036,000, which equaled the bank balances, at June 30, 2006 and 2005, respectively. As of June 30, 2006 and 2005, \$0 and \$100,000, respectively, of the Trust’s deposits was covered by depository insurance and the remainder was exposed to custodial credit risk as uninsured and uncollateralized.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

(b) Investments

Custodial Credit Risk – Investments. Custodial credit risk for investments is the risk that in the event of a failure of the counterparty, the Trust will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Trust does not have an investment policy for custodial credit risk.

The Trust primarily invests in guaranteed investment contracts (GICs), which under accounting principles generally accepted in the United States, are not subject to custodial credit disclosure because they are direct contractual investments and are not securities.

Credit Risk. The Trust has not adopted a formal policy related to credit risk. Although GICs are typically not rated, the GIC issuers are all rated AAA or AA. All GIC issuers that are rated lower than AAA are fully collateralized at 105% with U.S. Treasury securities or government-backed agency notes. MMDT is not rated.

The fair value and maturities of the Trust's investment are presented below (in thousands):

Investment type	Investment maturities (in years)					
	2005	2006	Less than 1	1 to 5	6 to 10	More than 10
	Fair value					
Debt securities:						
Guaranteed investment contracts	\$ 1,337,812	1,377,242	82,772	398,328	351,853	544,289
Cash equivalent:						
Massachusetts Municipal Depository Trust (MMDT)	267,765	281,797				
Total investments	\$ 1,605,577	1,659,039				

Concentration of Credit Risk. Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Trust places no limit on the amount that may be invested in any one issuer. More than 5% of the Trust's total investments are with the following issuers:

	Percent of total investments
Issuer:	
FSA Capital Management Services, LLC	22%
IXIS Funding Corp.	22
Societe Generale	5
Trinity Funding Company, LLC	24

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

Interest Rate Risk. The Trust does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair-value losses arising from increasing interest rates.

(4) Capitalization Grants

The Water Pollution Abatement Trust is the recipient of federal capitalization grants for the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund. Each of these grants is awarded annually by the federal government, and each requires a state matching grant equal to 20% of the federal grant amount (or 1/6th of the total). Generally, conditions of the grants require that the Trust enter into binding commitments with local governmental units within one year and draw such grants within two years of the grant awards.

Each grant also requires that a portion of the grant be expended for purposes other than the construction of projects within the State Revolving Fund programs. These are referred to as “set-asides,” and include a 4% allowance for administrative costs and for the drinking water program local assistance, additional assistance for small systems, and state program management.

The Trust recognizes federal capitalization grants and state matching funds as revenue when all eligibility criteria have been met. As a result, there may be timing differences in the recognition of federal and state funds. In 2006, the state program management set-aside portion of the federal Drinking Water grant, totaling \$2.7 million, had been awarded, but was not received by year end. As a result, certain amounts reflected in the table below may differ from the amount recorded in the accompanying financial statements.

The table below describes the grant agreements for 2006 and 2005:

Clean water program	Fiscal year	
	2006	2005
Federal capitalization award	\$ 36,586	45,385
State match on federal funds (20%)	7,317	18,277
Total capitalization grant	43,903	63,662
Less federally mandated administrative “set-asides”	(1,463)	(1,815)
Project capitalization	\$ 42,440	61,847

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

Drinking water program	Fiscal year	
	2006	2005
Federal capitalization awarded	\$ 29,621	29,684
State match on federal funds (20%)	5,924	11,937
Total capitalization grant	35,545	41,621
Less federally mandated administrative “set-asides”	(6,227)	(5,103)
Project capitalization	\$ 29,318	36,518

The Clean Water State Revolving Fund Loan Program is unchanged from previous years. The total federal award and the state matching funds of 20% are reduced by 4% for an administrative allowance. The total amount available for financing is net of this allowance.

(5) Loans Receivable and Bonds Purchased

The Trust issued a total of 97 and 79 loan or bond purchase agreements during fiscal 2006 and 2005, respectively. An additional 45 and 41 loans were disbursements under the Community Septic Management Program Fund in 2006 and 2005. Pursuant to agreements with the EPA, bond purchase agreements are used for extended financing with terms beyond 20 years. In 2005, 11 of the 79 agreements issued and 8 of the 97 agreements issued in 2006 were issued as 30-year bond purchase agreements to the towns of Kingston, Marion, Richmond, New Bedford and the MWRA, for at total of \$85.1 million.

A summary of these receivables as of June 30, 2006 and 2005 is as follows (amounts in thousands):

	2006	2005
Leveraged loans or bonds purchased	\$ 2,692,350	2,496,802
Direct loans	69	89
Interim loans	46,476	33,433
	2,738,895	2,530,324
Current portion	171,382	141,954
Long-term portion	\$ 2,567,513	2,388,370

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

Aggregate principal maturities on loans receivable or bonds purchased are as follows (amounts in thousands):

2007	\$	122,439
2008		128,690
2009		131,959
2010		134,907
2011		136,844
Thereafter		<u>2,037,511</u>
	\$	<u><u>2,692,350</u></u>

Interim loans of \$37,348,014, and direct loans of \$19,000 also mature in 2006.

Subsidy payments to be applied to repayments from borrowers include interest earnings provided by Debt Service Reserve Funds and contract assistance provided to the Trust by the Commonwealth. Both of these subsidies are expected to be available for the lives of the financing agreements. For the leveraged bond purchase program, pursuant to an agreement with the Commonwealth, subsidies are drawn in an amount as if the financing was for a twenty-year period. The amount that is not currently needed is invested at the applicable bond yield until funds are needed for subsidies beyond year 20, similar to an annuity. If subsidy funds are not available, the obligation of the borrower is increased by such shortfall.

The agreement requires the borrower to pay the Trust an annual or semiannual servicing fee equal to 0.15% or 0.075%, respectively, of the principal obligation outstanding on the applicable date. As of June 30, 2006, all borrowers have opted for the semiannual payment schedule. None of these fees are capitalized as part of a borrower's obligation to the Trust.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

(6) Bonds Payable

The following is a summary of bonds payable at June 30, 2006 and 2005 (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Water Pollution Abatement					
Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	\$ 6,565	—	1,190	5,375	1,090
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	5,430	—	770	4,660	735
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	6,580	—	860	5,720	835
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	12,970	—	1,305	11,665	1,280
Series 2002A, 3.0% to 5.25%, issued October 15, 2002, due 2003 to 2032	91,550	—	3,270	88,280	3,365
South Essex Sewage District					
Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	7,340	—	1,075	6,265	1,025
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	8,365	—	1,005	7,360	955
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	11,985	—	1,645	10,340	1,570
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	25,270	—	3,420	21,850	2,655
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	9,680	—	2,335	7,345	2,460
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	33,310	—	6,845	26,465	7,070

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Pool Loan Program:					
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	\$ 50,800	—	7,620	43,180	7,800
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	94,300	—	11,340	82,960	11,610
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	135,290	—	13,890	121,400	14,245
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2021	230,305	—	11,625	218,680	13,115
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	143,455	—	9,925	133,530	10,085
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	301,265	—	10,440	290,825	10,875
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2028	317,175	—	10,145	307,030	10,290
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2029	—	293,760	—	293,760	7,220
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	110,675	—	2,755	107,920	2,940
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	302,085	—	9,235	292,850	9,845
Pool Program Refunding:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	645,620	—	960	644,660	980
Subtotal	2,550,015	293,760	111,655	2,732,120	122,045
Less unamortized amounts:					
Bond premium	114,860	10,309	4,420	120,749	—
Net unamortized excess of reacquisition price over net carrying value of defeased bonds	(50,954)	—	(2,243)	(48,711)	—
Total bonds payable	\$ 2,613,921	304,069	113,832	2,804,158	122,045

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

The following is a summary of bonds payable at June 30, 2005 and 2004 (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Water Pollution Abatement					
Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	\$ 7,840	—	1,275	6,565	1,190
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	6,230	—	800	5,430	770
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	7,460	—	880	6,580	860
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	14,300	—	1,330	12,970	1,305
Series 2002A, 3.0% to 5.25%, issued October 15, 2002, due 2003 to 2032	121,695	—	30,145	91,550	3,270
South Essex Sewage District					
Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	8,460	—	1,120	7,340	1,075
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	9,420	—	1,055	8,365	1,005
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	13,690	—	1,705	11,985	1,645
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	29,345	—	4,075	25,270	3,420
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	13,095	—	3,415	9,680	2,335
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	40,440	—	7,130	33,310	6,845

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	\$ 122,050	—	71,250	50,800	7,620
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	230,635	—	136,335	94,300	11,340
Series 6, 4.5% to 5.66% issued November 6, 2000, due 2001 to 2030	303,730	—	168,440	135,290	13,890
Series 7, 3.0% to 5.25% issued July 15, 2001, due 2001 to 2021	299,930	—	69,625	230,305	11,625
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	257,800	—	114,345	143,455	9,925
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	311,580	—	10,315	301,265	10,440
Series 10, 2.5% to 5.25%, issued November 3, 2004, due 2005 to 2028	—	317,175	—	317,175	10,145
Subordinated Revenue Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	113,260	—	2,585	110,675	2,755
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	368,435	—	66,350	302,085	9,235
Pool Program Refunding:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	—	645,620	—	645,620	960
Subtotal	2,279,395	962,795	692,175	2,550,015	111,655
Less unamortized amounts:					
Bond premium	37,792	87,852	10,784	114,860	—
Net unamortized excess of recquisition price over net carrying value of defeased bonds	(7,088)	(45,827)	(1,961)	(50,954)	—
Total bonds payable	\$ 2,310,099	1,004,820	700,998	2,613,921	111,655

All bonds are payable from amounts pledged pursuant to the Water Pollution Abatement Project Bond Resolutions, which include payments by the local governmental units of principal and interest on the loans

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

and amounts on deposit in the Debt Service Reserve Funds. Pursuant to the Commonwealth Assistance Contract (the Contract), the Commonwealth has agreed to provide Contract Assistance payments to the Trust to reduce the payments by local governmental units. The Contract is not pledged as security for the bonds; however, the Contract Assistance payments, when received by the Trust, are pledged as security for the bonds.

In October 2005, the Trust issued \$293.7 million in new bonds with its Pool Program Series 11. These monies were used to finance water pollution abatement and drinking water projects in 55 communities and special districts.

In August 2004, the Trust issued \$645.6 million in refunding bonds (at a true interest cost of 4.03%) as a partial advanced refunding of several previous Trust bond issues. The issues that were partially refunded were: Pool Program Series 4, 5, 6, 7, and 8 and MWRA Loan Program Series 1999A and 2002A. The total debt defeased through this new issue was \$592.9 million, for a savings of \$42.9 million, resulting in an economic gain (net present value) of \$26.7 million.

All issuance costs of the transaction were paid from bond proceeds, and the required debt service reserves were invested in Guaranteed Investment Contracts (GICs). The remaining proceeds were deposited with an escrow agent to provide resources for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. The reacquisition price exceeded the net carrying amount of the old debt by \$45.8 million, which is being netted against the new debt issued.

In November 2004, the Trust issued \$317.2 million in new bonds with its Pool Program Series 10. These monies were used to finance water pollution abatement and drinking water projects in 55 communities and special districts.

	Total debt service	Principal	Interest
Year ending June 30:			
2007	\$ 258,746	122,045	136,701
2008	258,219	129,955	128,264
2009	254,216	131,735	122,481
2010	251,779	135,340	116,439
2011	248,479	138,320	110,159
2012-2016	1,165,753	713,500	452,253
2017-2021	934,041	669,275	264,766
2022-2026	549,433	432,280	117,153
2027-2031	224,605	182,790	41,815
2032-2036	83,853	76,880	6,973
	<u>\$ 4,229,124</u>	<u>2,732,120</u>	<u>1,497,004</u>

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

The balances of bonds defeased “in-substance” in prior years and still outstanding as of June 30 are as follows (amounts in thousands):

Description	Redemption date	Outstanding principal amount	
		2006	2005
MWRA Loan Program:			
Series 1993A	November 3, 1999	\$ 59,910	66,905
Series 1993B	November 3, 1999	42,990	46,295
Series 1995A	November 3, 1999	47,015	50,055
Series 1998A	November 3, 1999	83,385	86,610
Series 1999A	August 25, 2004	57,705	57,705
Series 2002A	August 25, 2004	26,980	26,980
New Bedford Loan Program:			
Series 1996A	December 23, 1998	77,660	83,435
South Essex Sewage District Loan Program:			
Series 1996A	July 15, 2001	45,060	48,035
Pool Loan Program:			
Pool 2	July 15, 2001	20,720	20,720
Pool 3	July 15, 2001	51,695	51,965
Pool 4	August 25, 2004	63,765	63,765
Pool 5	August 25, 2004	125,240	125,240
Pool 6	August 25, 2004	154,850	154,850
Pool 7	August 25, 2004	59,330	59,330
Pool 8	August 25, 2004	105,045	105,045

(7) Net Assets

As of June 30, 2006 and 2005, the Trust has restricted net assets in the amount of \$1,390,493 and \$1,322,417,000, respectively, and unrestricted net assets in the amount of \$142,410,000 and \$112,955,000, respectively. Restricted net assets represent capitalization grants received cumulative to date from the U.S. Environmental Protection Agency and corresponding matching amounts received from the Commonwealth of Massachusetts. The capitalization grants are restricted to provide financial assistance, but not grants, to local communities and interstate agencies for the construction of wastewater treatment works, drinking water infrastructure improvements, and other related projects as described in note 1. During 2006, certain reclassifications were made to prior year restricted and unrestricted balances to conform to the current year presentation.

**MASSACHUSETTS WATER
POLLUTION ABATEMENT TRUST**
(A Component Unit of the Commonwealth of Massachusetts)

Notes to Financial Statements

June 30, 2006 and 2005

In 2006 and 2005, the Trust received \$654 thousand and \$3.130 million, respectively, in contract assistance from the Commonwealth that, because of a bond refunding, was not needed to repay bond principal or interest due in fiscal 2005 or 2006. These funds have been presented as restricted net assets of \$3.8 million and placed in a separate bank account which requires the Commonwealth's approval prior to use of the funds.

(8) Commitments

As of June 30, 2006 and 2005, the Trust has agreed to provide loans to various local government units amounting to approximately \$64.7 million and \$35.4 million, respectively, excluding loans to be disbursed, which will be funded or collateralized with grant awards received by the Trust.

(9) Policy Revision

In October 2005, the Trust issued \$293,760,000 of Massachusetts Water Pollution Abatement Trust Pool Program Bonds, Series 11. In conjunction with this bond issue, the Trust revised its bond resolution and standard loan and bond purchase agreements substantially. The purpose of these revisions was to separate the cash flows and security of the Series 11 loan portfolio from the Series 11 bonds. This provides more flexibility to the Trust and its borrowers while making the program easier to account and budget for. Below is a summary of the principal changes to the credit structure.

(a) *Elimination of "Matched Book" Policy*

Beginning with the Series 11 bonds, the Trust will show sufficiency of aggregate cash flows necessary to repay the bonds, rather than matching the principal, interest, and subsidies within the loan portfolio with the principal, interest, and subsidies within the bond portfolio. This resulted in cumbersome accounting and budgeting requirements for both the Trust and its borrowers.

(b) *Par Loan Structure*

All loans will be made at a par amount equal to the amount borrowed. Prior to Series 11, any bond premium realized by the Trust was passed through to the communities as a grant, which then reduced the par amount of the loan. As a result of this change, in FY06, grant disbursements by the Trust were eliminated, compared to \$20.8 million in FY05.

(c) *Elimination of Gross Pledge*

Communities now are required to provide a pledge equal to the amount of principal and interest due to the Trust, net of subsidies by the Trust and the Commonwealth. Prior to this change, communities were required to pledge the gross amount of the loan at a rate equal to the rate paid by the Trust on its bonds.